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# In the Supreme Court of the United States

OCTOBER TERM, 1950

No. .....

A. HAAS, *Petitioner*,

vs.

PALACE HOTEL COMPANY OF SAN FRANCISCO, a Corporation, AMERICAN TRUST COMPANY, a Corporation, et al.

## Petition for a Writ of Certiorari

**To the District Court of Appeal of the State of California, First Appellate District, Division One**

Petitioner prays that a Writ of Certiorari be issued to review the judgment of the District Court of Appeal of the State of California, First Appellate District, Division One, entered in the above-entitled case on December 12, 1950.

### OPINION BELOW

The opinion of the District Court of Appeal of the State of California (R. 81) is reported in 101 A.C.A. 132, 224 P.2d 783 (1950). The Palace Hotel Company and the American Trust Company are the defendants below, and the Bank of California, Crocker First National Bank of San Francisco, and the Wells Fargo Bank & Union Trust Co., are the intervener below.

## JURISDICTION

The judgment of the District Court of Appeal was entered on December 12, 1950 (R. 81). A petition for rehearing, seasonably filed, was denied on January 11, 1951 (R. 96); and a petition for a hearing by the Supreme Court of the State of California, seasonably filed, was denied on February 9, 1951 (R. 98). The jurisdiction of this Court is invoked under 28 U.S.C.A., Section 1257(3), in that the California District Court of Appeal has denied petitioner rights claimed by her under the Trust Indenture Act of 1939 (15 U.S.C.A. §§ 77aaa *et seq.*). The application of the Trust Indenture Act was urged by petitioner at every stage in the state courts. Petitioner alleged in her complaint that the Supplemental Indenture of 1945, hereinafter referred to, was subject to such Act (R. 8). In petitioner's Memorandum of Points and Authorities in support of her complaint, filed with the trial court, she contended that by reason of such Act she was entitled to maintain her action. Section 316(b) of the Act (15 U.S.C.A. § 77ppp(b)) was cited and relied on (R. 72). The application of the Act was urged before the District Court of Appeal and that Court stated in its opinion:

> "This is a complete answer to appellant's contentions in reference to Section 316(b) of the Trust Indenture Act of 1939. That Section, whatever its proper interpretation, has no application to bonds issued in 1925." (R. 90)

The claim to relief under the Act was again urged in the Petition for Rehearing by the District Court of Appeal (R. 95) and in the Petition for Hearing by the Supreme Court of California (R. 97).

## QUESTIONS PRESENTED

(1) Where a mortgage securing bonds issued prior to 1939 is amended by supplemental indenture to comply with the Trust Indenture Act of 1939 (15 U.S.C.A. §§ 77aaa et seq.) in order to extend the maturity of the bonds consenting to the extension, do the benefits of the Act apply only to consenting bonds or to both consenting and non-consenting bonds?

(2) Does Section 316(b) of the Trust Indenture Act (15 U.S.C.A. § 77ppp(b)) insure bondholders within the protection of such Act a remedy to enforce payment of bonds at maturity?

## STATUTORY PROVISIONS INVOLVED

The pertinent provisions of the Trust Indenture Act of 1939 (15 U.S.C.A. §§ 77aaa *et seq.*) involved herein are the following:

*Sec. 316(b)*—

"The indenture to be qualified shall provide that, notwithstanding any other provision thereof, the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder, except as to a postponement of an interest payment consented to as provided in paragraph (2) of subsection (a), and except that such indenture may contain provisions limiting or denying the right of any such holder to institute any such suit, if and to the extent that the institution or prosecution thereof or the entry of judgment therein would, under applicable law, result in the surrender,

impairment, waiver, or loss of the lien of such indenture upon any property subject to such lien." 15 U.S.C.A. § 77ppp(b).

*Sec. 303*—

"When used in this subchapter, unless the context otherwise requires—

• • • • • • • •

"(7) The term 'indenture' means any mortgage, deed of trust, trust or other indenture, or similar instrument or agreement (including any supplement or amendment to any of the foregoing), under which securities are outstanding or are to be issued, • • •"

• • • • • • • •

"(9) The term 'indenture to be qualified' means (A) the indenture under which there has been or is to be issued a security in respect of which a particular registration statement has been filed, or (B) the indenture in respect of which a particular application has been filed."

• • • • • • • •

"(11) The term 'indenture security' means any security issued or issuable under the indenture to be qualified." (15 U.S.C.A. §§ 77ccc (7, 9, 11).

*Sec. 304*—

"(a) The provisions of this title shall not apply to any of the following securities: • • •"

"(3) any security which, prior to or within six months after the enactment of this title, has been sold or disposed of by the issuer or bona fide offered to the public, but this exemption shall not apply to any new offering of any such security by an issuer subsequent to such six months; • • •" U.S.C.A. § 77ddd(a)(3).

## STATEMENT

Petitioner is the holder of bonds in the principal amount of $63,000 (R. 5) issued by the Palace Hotel Company in 1925 as part of a $2,500,000 issue of bonds secured by a First Mortgage (herein referred to as the "Original Mortgage") to the American Trust Company, as Trustee (R. 3). These bonds provide for the payment of 5% interest semiannually, and the payment of principal on February 1, 1945 (R. 3, 14). Article VII of the Original Mortgage contained the then customary restriction prohibiting any action under the Original Mortgage unless the holders of 25% in face amount of the bonds had first requested the Trustee to take such action on their behalf (R. 61). There was no provision in the Original Mortgage or the bonds for modification thereof.

On February 1, 1945, Petitioner's bonds became due. They were not then paid, nor have they since been paid, nor has Petitioner received any interest since that time.

After default on all of the bonds, a so-called voluntary plan of reorganization was presented to the bondholders which provided for the extension of the maturity of the bonds to February 1, 1965, and a reduction of interest from 5% to 4% as to all of the bondholders who consented.

The plan required and received the consent of the holders (hereinafter referred to as the "consenting bondholders") of more than 75% in face amount of the outstanding bonds. No such consent was given as to petitioner's bonds (petitioner and others like her are herein referred to as the "nonconsenting bondholders").

To effectuate the plan, it was necessary to make application to the Securities and Exchange Commission for quali-

fication of the Original Mortgage under the Trust Indenture Act. The Original Mortgage was so qualified by amendments contained in a Supplemental Indenture, dated February 1, 1945 (herein referred to as the "1945 Indenture") (R. 8). The 1945 Indenture provided that certain provisions of the Original Mortgage, including Article VII, "are hereby cancelled, annulled and rescinded and there shall be and are hereby substituted in lieu thereof the following Articles III to XVIII, inclusive." (R. 19). Among the provisions thus substituted is Section 10.19 of the 1945 Indenture, which contains restrictions similar to those of Article VII of the Original Mortgage, but with an added proviso required by Section 316(b) of the Trust Indenture Act, as follows:

> "Notwithstanding any other provision of this Indenture, the right of the holder of any Bond to receive payment of the principal of and interest on such Bond, on or after the respective due dates expressed in such Bond, or to institute suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder, except that no Bondholder may institute any such suit, action or proceeding if and to the extent that the institution or prosecution thereof or the entry of a judgment or a decree herein would, under applicable law, result in the surrender, impairment, waiver or loss of the lien of this Indenture upon any property subject to such lien." (R. 36)

On January 3, 1949, petitioner requested the Trustee to enforce payment of such bonds and coupons, and the Trustee refused (R. 10). Thereafter, this action to enforce payment was instituted in the Superior Court of the State of

California in and for the City and County of San Francisco. The three banks intervened as bondholders and/or as representatives of bondholders who had consented to the plan of reorganization. The Defendant and Interveners demurred to the complaint herein, and the demurrer was sustained with leave to amend. Petitioner declined to amend; judgment of dismissal was entered. Petitioner appealed to the Supreme Court of the State of California and the appeal was assigned to the District Court of Appeal, First Appellate District, Division One. The District Court of Appeal affirmed the judgment (R. 81). Petitions for rehearing by the District Court of Appeal and for hearing by the Supreme Court of California were subsequently denied (R. 96, 98).

## SPECIFICATION OF ERRORS TO BE URGED

The California District Court of Appeal erred:

(1) In holding that the Trust Indenture Act of 1939 does not apply to mortgage bonds not consenting to an extension of maturity which had necessitated qualification of the mortgage under such Act;

(2) In holding that the cancellation of the restrictive provisions of the Original Mortgage which were repugnant to the Trust Indenture Act did not apply to non-consenters;

(3) In holding that the provision required by the Trust Indenture Act to be inserted in the Original Mortgage relating to the enforcement of payment of the bonds upon maturity did not apply to non-consenters;

(4) In failing to hold that petitioner had a remedy to enforce payment of her bonds at maturity under Section 316(b) of the Trust Indenture Act and the corresponding provision of the Original Mortgage as amended;

(5) In affirming the judgment of dismissal of the trial court.

## REASONS FOR GRANTING THE WRIT

Petitioner has consistently claimed that her right to maintain this action to enforce payment of her bonds is guaranteed by the Trust Indenture Act of 1939. Since the decision below denies this right, there can be no doubt as to the propriety of granting a writ of certiorari. *Logan v. Davis*, 233 U.S. 613, 623 (1914); *Brooklyn Savings Bank v. O'Neil*, 324 U.S. 697 (1945).

It is not only proper but vitally important that the writ be granted to settle the two questions which are presented.

### Application of the Trust Indenture Act to Non-consenting Bondholders

(1) The holding of the California District Court of Appeal that the Trust Indenture Act did not apply to petitioner is in direct conflict with a decision of the Securities and Exchange Commission. *Hugo Stinnes Corp.*, 7 S.E.C. Decisions and Reports 622 (1940). The *Stinnes* ruling, rendered shortly after the passage of the Trust Indenture Act, involved facts substantially the same as in the present case. The Hugo Stinnes Corporation proposed to extend the maturity of notes issued in 1926 and maturing in 1940 as to noteholders who consented to the extension plan. As in the present case, it was therefore necessary to qualify the original indenture under the Trust Indenture Act. The supplemental indenture offered for this purpose attempted to limit the application of the protective features required by the Act to consenting noteholders. The Securities and Exchange Commission unequivocally ruled that the protec-

tive features must apply to all noteholders, consenting and nonconsenting alike, employing the following reasoning:

"It is urged by counsel for the Registration Division that the indenture cannot be qualified in its present form. We agree that unless the protective features required to be included by the Act and from which no exemption is available, are made applicable to *all* indenture security holders, qualification cannot be permitted. The Act very clearly provides that for qualification to ensue an indenture under which any new offering is to be made *must* make the provisions required to be included by the Act applicable to 'the indenture securities' or 'security holders.' (See discussion *supra* with regard to Sections 311(a), 310(b), 315(b), 313(c), 312(a), (b) and 317(b).)

"An 'indenture security' is defined by Section 303 (11) to mean 'any security *issued* or issuable under the indenture to be qualified.' Under Section 303 (7) and (9) the term 'indenture to be qualified' is defined to include any indenture together with any supplements or amendments thereto.

"The nonassenting securities and security holders are therefore within the specific terms of the sections requiring inclusion of protective provisions.

"Thus, except to the extent that we may find that an exemption from the requirement of general application to all holders is available under Section 304 (c) or (d), provisions, such as those described above, which must be included in the indenture pursuant to the requirements of the Act must be made applicable to all noteholders."

*Hugo Stinnes Corp.* 7 S.E.C. Decisions and Reports, 622, 637 (1940).

This decision has never been questioned. It has been followed as a matter of administrative practice for more than

eleven years. It is well established that the ruling of an agency charged with the administration of a statute is entitled to great weight. *Norwegian Nitrogen Products Co. v. United States*, 288 U.S. 294, 315 (1933); *Securities and Exchange Commission v. Associated Gas & Electric Co.*, 99 F.2d 795, 798 (C.C.A.2d 1938). Yet, the California decision below reaches a directly contrary result without even mentioning the *Stinnes* case or considering its reasoning.

(2) It is submitted that the decision of the Securities and Exchange Commission in the *Stinnes* case is correct and the holding of the Court below is erroneous. The California District Court of Appeal dismissed the Trust Indenture Act as inapplicable to nonconsenting bondholders because of Section 304(a) of the Act (15 U.S.C. § 77ddd (a)), which provides:

> "The provisions of this title shall not apply to any of the following securities: * * *
>
> "(3) any security which, prior to or within six months after the enactment of this title, has been sold or disposed of by the issuer or bona fide offered to the public, but this exemption shall not apply to any new offering of any such security by an issuer subsequent to such six months; * * *"

The Securities and Exchange Commission was aware of this exemption in deciding the *Stinnes* case, since it was referred to in a footnote (7 S.E.C. Decisions and Reports at 626); but it was apparently considered not applicable. The obvious purpose of the exemption was to prevent the complete disruption of corporate bond financing which would result if every bond issue being offered to the public or in the advanced stages of preparation at the time of the

enactment of the Trust Indenture Act had to be withdrawn or interrupted for the purpose of qualifying under the Act. By its very terms the exemption does not apply to any "new offering" after the six months period of grace. The extension of the maturity of the consenting bonds constituted a "new offering" within the meaning of the Act. *Securities and Exchange Commission v. Associated Gas & Electric Co.*, 99 F.2d 795 (C.C.A.2d 1938). The exemption of Section 304(a) therefore dropped out, and it was necessary to qualify the Original Mortgage under the Trust Indenture Act.

To qualify the Original Mortgage it was necessary, among other things, to amend it to comply with Section 316(b) of the Act, which reads:

> "The *indenture to be qualified* shall provide that • • • the right of any holder of any *indenture security* to receive payment of the principal • • • on such *indenture security*, on or after the respective due dates expressed in such *indenture security*, or to institute suit for the enforcement of any such payment • • • shall not be impaired • • •" [Emphasis added.]

Specific definitions are found in the Act for the words in italics above (quoted *supra* at p. 4). "The term 'indenture' means any mortgage • • • under which securities are outstanding or are to be issued." The Original Mortgage is such an "indenture." "The term 'indenture to be qualified' means • • • the indenture in respect of which a particular application has been filed." An application in respect of the Original Mortgage was filed in order that it might be qualified under the Act. "The term 'indenture security' means any security issued or issuable under the indenture

to be qualified." Petitioner's bonds were issued under the indenture to be qualified, that is, the Original Mortgage.

That the parties to the 1945 Indenture considered the foregoing construction of Section 316(b) to be the correct construction is clear from the language of Section 10.19 of the Indenture. There the word "Bond" is used, instead of "indenture security" as in the Act. In the 1945 Indenture, the term "Bond" is defined as follows:

> "• • • The terms *'Bond'* or *'Bonds'* shall mean and include not only the 1965 Bonds but also the 1945 Bonds to the extent that it is legally permissible to extend the benefits of and to apply the terms and provisions of the Mortgage of Chattels and Trust Indenture, dated as of February 1, 1945, to the holders of the 1945 Bonds." (R. 20)

The 1965 Bonds are the consenting bonds and the 1945 Bonds are the nonconsenting bonds.

The 1945 Indenture contains other clear indications that the parties thereto *intended* to follow the holding of the *Stinnes* case. The Hugo Stinnes Corporation offered for qualification a supplemental indenture containing the following provision:

> "Nothing • • • shall be construed to • • • extend or to confer upon any person other than a holder of assented notes, the Corporation and the American trustee any right or interest to avail themselves of any of the terms or provisions hereof and nothing herein shall, or shall be construed to, extend to or confer upon the holders or owners of the Corporation's notes who are not parties hereto any new, additional or different rights or benefits." *Hugo Stinnes Corp.*, 7 S.E.C. 622, 637 (1940).

The Securities and Exchange Commission held that this provision was objectionable because inconsistent with the requirement that the protective provisions of the Trust Indenture Act apply to all bondholders, consenting and non-consenting. By way of contrast the 1945 Indenture contains the following provision:

> "* * * This Mortgage of Chattels and Trust Indenture is not intended to, does not, and shall not be construed to affect, impair, change or modify, in any manner or to any extent whatsoever, any of the rights, powers or privileges of the holders of the 1945 Bonds; nor to relieve the Company or the Trustee from any duty or obligation to any holder of the 1945 Bonds under the terms and provisions thereof or of the Original Mortgage or said Chattel Mortgage dated December 7, 1933; nor to grant to or confer upon the Trustee or the holders of 1965 Bonds any rights or powers as against any holder of 1945 Bonds not granted or conferred under the provisions of the Original Mortgage or said Chattel Mortgage dated December 7, 1933; *provided, however,* that, to the extent permitted by law, all of the rights, provisions, benefits and remedies provided in this Mortgage of Chattels and Trust Indenture in favor of the holders of any of the outstanding bonds, including, but not limited to, the security and benefits of the sinking fund provided for in the amended Article VI, the benefits of the redemption provisions provided for in the amended Article V and the waiver of the statute of limitations provided for in Section 7.17, shall be available to and inure to the benefit of the holders of 1945 Bonds." (R. 38-9)

A comparison of these two provisions indicates an unmistakable intention on the part of the draftsmen of the Palace

Hotel 1945 Indenture to achieve a result contrary to that of the Stinnes indenture and in accord with the holding of the S.E.C. in the *Stinnes* ruling.

(3) The importance of granting a writ to review the decision of the California Court below as to the scope of application of the Trust Indenture Act extends far beyond the immediate desirability of correcting the error which has inequitably deprived petitioner of any means of enforcing payment of her overdue bonds. The decision below not only deprives the nonconsenting holders of Palace Hotel bonds of the protection of the Trust Indenture Act, but potentially has a similar adverse effect on every holder of bonds issued prior to the effective date of the Act and maturing after such date. Many millions of dollars of bonds isued under indentures prior to the Act are still outstanding; and, in many cases, such indentures have subsequently been qualified under the Trust Indenture Act, either because of subsequent serial issues or extensions of maturity. The holding of the Court below not only incorrectly narrows the protection of paramount rights at maturity by Section 316(b); it likewise restricts the scope of application of all of the other remedial provisions of the Act, including the right of bondholders to receive reports and to obtain information, and the obligation of Trustees to them.

Independent of whether the decision below is correct or incorrect, it is of the utmost importance to resolve the conflict between that holding and the ruling of the Securities and Exchange Commission. Heretofore, pursuant to the ruling of the Securities and Exchange Commission in the *Stinnes* case, that body has required that the protective provisions of the Trust Indenture Act be made applicable

to *all* bonds which have been issued or are to be issued under a mortgage which is subsequently qualified, unless an exemption is obtained pursuant to Section 304(c) of the Trust Indenture Act [15 U.S.C.A. § 77ddd(c)]. The resulting uncertainty will seriously interfere with the orderly administration of the Trust Indenture Act. Registration statements and prospectuses have stated that the remedial provisions were so applicable. Apropriate changes will also have to be made in the requirements for registration under the Securities Act of 1933 if the decision below is correct.

**Construction of Section 316(b) of the Trust Indenture Act in "One-action" States**

(1) Respondents will doubtless urge in reply to this petition, as they have argued below, that the Trust Indenture Act does not entitle petitioner to relief even if it is applicable to her. Their argument is essentially that Section 316(b) insures only an action at law on bonds, and that the "one-action" rule* prohibits such an action in states like California. The Court below did not directly pass on this question, since it held the Section completely inapplicable. However, once this error is corrected the issue is squarely presented: does Section 316(b) of the Trust Indenture Act guarantee a remedy at maturity, or is it completely without effect in "one-action" states?

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*California Code of Civil Procedure § 726 provides:
"There can be but one form of action for the recovery of any debt, or the enforcement of any right secured by mortgage upon real or personal property, which action must be in accordance with the provisions of this chapter [i.e., foreclosure] * * *" Substantially identical statutes are in force in Idaho [Idaho Laws Ann., Title 9-101 (1943)]; Montana [Mont. Rev. Codes 93-6001 (1947)]; Nevada [Nev. Comp. Laws, Hillyer § 9048 (1929)]; Utah [Utah Code Ann. §104-55-1 (1943)].

The need for a decision on this question of construction cannot be overemphasized. This question affects not only bonds issued prior to the effective date of the Trust Indenture Act; it concerns every bond issue in a "one-action" state, past or future, which is secured by an indenture qualified under the Act.

The California Court, relying on a line of pre-Trust Indenture Act cases which sustained the validity of restrictive provisions similar to Article VII of the Original Mortgage, has decided in effect that the holders of 75.1% of the bonds may alter the rights of the remaining bondholders in any manner they see fit and without the consent of the minority bondholders.* Holders of matured and overdue bonds may thus be left remediless for any length of time, despite the promise of the obligee to pay a fixed sum at a fixed time. This is directly in opposition to the provision which Congress placed in Section 316(b) of the Trust In-

*The Court below primarily relied on Article VII of the Original Mortgage as a bar to this action, rejecting petitioner's contention that it had been cancelled (R. 86-88); but held in the alternative that even if Article VII had been cancelled as to petitioner, the action was barred by the first part of Section 10.19 of the 1945 Indenture (R. 88). Neither alternative is sound. If Article VII and the other provisions of the Original Mortgage were cancelled as to consenting bondholders, then petitioner is the holder of more than one-fourth (¼) of the bonds secured by the unamended Original Mortgage and has complied with the 25% limitation (R. 47). If Article VII was cancelled as to petitioner, then the 25% restriction of Section 10.19 of the 1945 Indenture is inapplicable to petitioner's suit after maturity by reason of the further qualification therein that notwithstanding any other provision of the Indenture, the right of any bondholder to enforce payment after maturity shall not be impaired without his consent. The cases cited by the Court in support of the enforceability of 25% restrictions (R. 85-86) are not helpful, since none of those cases involved facts arising after the Trust Indenture Act, and none of the restrictive provisions involved were qualified, as in the instant case, by the provision required by Section 316(b) of that Act.

denture Act that the right of a bondholder within the protection thereof to receive and enforce payment at maturity could not be impaired *without his consent.*

(2) The decision below reaches the same result as the case of *Allan v. Moline Plow Co.*, 14 F.2d 912 (C.C.A. 8th 1926), a result which was criticized by the Securities and Exchange Commission in the report of its investigation which led to the passage of the Trust Indenture Act. Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, Part VI, p. 62 *et seq.* (1936). It is apparent that the Congressional intent behind Section 316(b) was to remedy precisely the evils permitted by the *Moline Plow Co.* case and the decision of the California District Court of Appeal in this case.

This intent clearly appears from the committee reports issued during the consideration of the proposed Trust Indenture Act by Congress, which stated that the intended effect of Section 316(b) was:

> "• • • to prohibit provisions authorizing such a majority to force a non-assenting security holder to accept a reduction or postponement of his claim for principal, or a reduction of his claim for interest or a postponement thereof for more than one year. Evasion of judicial scrutiny of the fairness of debt-readjustment plans is prevented by this prohibition." Senate Report 1619, 75th Congress, 3d Session, p. 19.

To the same effect: Senate Report 248, 76th Congress, 1st Session, p. 26; House of Representatives Report No. 1016, 76th Congress, 1st Session, p. 56. The result of the decision below is to permit debt-readjustment without any judicial scrutiny as to the fairness thereof.

Section 316(b) must be construed in one of three ways as applied to "one-action" states: (1) As invalidating restrictions on the right of minority bondholders to foreclose after the due date expressed in the bonds; (2) as guaranteeing an action at law for a personal judgment on the bonds, thereby waiving the "one-action" rule* by expression of an inconsistent result; or (3) as furnishing no protection at all to minority bondholders in such states. It is inappropriate to consider at length in this petition the arguments as to which is the proper construction. It is sufficient to note that either of the first two constructions serves to effectuate the expressed Congressional objective in enacting Section 316(b). To hold that Section 316(b) of the Act has no effect in a "one-action" state not only frustrates this objective, but leads to the conclusion that the Trust Indenture Act requires the inclusion in indentures of language which is completely misleading and a trap for the unwary in states like California.

(3) The result of the decision below cannot be justified by the exception at the end of Section 316(b), which provides:

> "* * * except that such indenture may contain provisions limiting or denying the right of any such holder to institute any such suit, if and to the extent that the institution or prosecution thereof or the entry of judgment therein would, under applicable law, result in the surrender, impairment, waiver, or loss of the lien of such indenture upon any property subject to such lien."

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*Waiver of this requirement is specifically permitted as to mortgages securing bonds authorized or permitted to be issued by the Commissioner of Corporations. California Civil Code 2953. The Palace Hotel bonds were issued under such a permit (R. 62).

Petitioner seeks either a decree of forecloseure or a judgment at law on her bonds. Foreclosure of a mortgage is in no sense a surrender, impairment, waiver, or loss of a lien; it is the enforcement of a lien.* Nor is there any authority to compel the conclusion that a judgment in favor of an individual bondholder at law after waiver of the "one-action" rule in advance, would in any way work a waiver or impairment of the security.

*If a decree of foreclosure were entered in this action, it would be for the benefit of all bondholders, consenting and non-consenting alike (R. 39).

## CONCLUSION

The decision below leaves a holder of matured bonds without any remedy. It places all minority bondholders in similar circumstances at the complete mercy of the majority bondholders, or, more accurately, at the mercy of bondholders' protective committees which purport but often fail to represent the interests of the individual bondholders. It achieves this result despite unmistakable Congressional intent to remedy this evil by the Trust Indenture Act and despite an unchallenged ruling and longstanding administrative practice of the Securities and Exchange Commission directly to the contrary.

It is of the utmost importance to petitioner, countless other bondholders, and the Securities and Exchange Commission, that the decision below be reviewed by this Court.

We submit that for the foregoing reason this petition for a writ of certiorari should be granted.

Respectfully submitted,

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| Claridge Apartments Co. v. Commissioner of Internal Revenue, 323 U.S. 141, 65 S.Ct. 172 (1944) | 5 |
| Dietzel v. Anger, 8 Cal.2d 373, 65 P.2d 803 (1937) | 7 |
| Hassett v. Welch, 303 U.S. 303, 58 S.Ct. 559 (1938) | 5 |
| Hugo Stinnes Corp., 7 S.E.C. Dec. and Rep. 622 (1940) | 5, 9 |
| Lauinger v. Carrillo Building Co., 41 Cal. App.2d 660, 107 P.2d 287 (1940) | 7 |
| Miller v. United States, 294 U.S. 435, 55 S.Ct. 440 (1935) | 5 |
| Rodman v. Richfield Oil Co. of California, 66 F.2d 244 (9th Cir. 1933) | 7 |
| Securities and Exchange Commission v. Associated Gas & Electric Co., 99 F.2d 795 (2d Cir. 1938) | 4 |

| Statutes | |
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| California Code of Civil Procedure, Section 726 | 2, 7, 8, 9, 10 |
| Trust Indenture Act of 1939, 53 Stat. 1149, 15 U.S.C.A. §§77aaa, et seq. | |
| In General | 2, 3, 4, 5, 6, 9, 10 |
| Section 304(a)(3), 53 Stat. 1153, 15 U.S.C.A. §77ddd(a)(3) | 4, 10 |
| Section 316(b), 53 Stat. 1173, 15 U.S.C.A. §77ppp(b) | 3, 6, 7 8, 9, 10 |

| Miscellaneous | |
|---|---|
| 84 Cong. Rec. 9528, Part 9, 76th Cong., 1st Sess. (July 19, 1939); 1 CCH Fed. Sec. L. Serv., para. 14,221.12 | 8, 9 |

# In the Supreme Court of the United States

OCTOBER TERM, 1950

**No. 725**

A. HAAS, *Petitioner,*

vs.

PALACE HOTEL COMPANY OF SAN FRANCISCO, a Corporation, AMERICAN TRUST COMPANY, a Corporation, et al., *Respondents.*

## Answer of Respondent and Interveners to Petition for a Writ of Certiorari

### JURISDICTION

Jurisdiction to consider the petition is admitted, but certiorari should be denied for want of any substantial federal question.

### STATEMENT

Petitioner is a holder of so-called 1945 Bonds issued by Palace Hotel Company of San Francisco in 1925, and secured by what is known as the Original Mortgage. In 1945 the holders of more than 76 per cent of the outstanding bonds consented to a Plan whereby, under the so-called 1945 Indenture, their bonds were extended for 20 years and their interest rate was reduced. Petitioner has never consented to the Plan or the 1945 Indenture, and her

bonds remain unchanged as to principal, interest and maturity date.

The California courts held that petitioner has no present cause of action under applicable state law to enforce payment of her bonds, first, because the Original Mortgage and the 1945 Indenture both contain a 25 per cent clause (prohibiting foreclosure unless the holders of one-fourth of the outstanding bonds consent thereto), with which she cannot comply; second, because the "one action" rule embodied in California Code of Civil Procedure, Section 726 prohibits her bringing an action at law until the security has been exhausted.

Petitioner's statement of facts is substantially correct with the important exception that her complaint alleged, and the record before the lower courts on demurrer therefore showed, that it was the 1945 Indenture which was required to be and was qualified under the Trust Indenture Act of 1939 (Complaint, R. 8). The complaint does not allege, and so petitioner cannot be heard to say now, that the Original Mortgage under which her bonds were issued and sold was required to be qualified under the Trust Indenture Act.

## REASONS FOR DENYING CERTIORARI

Petitioner seeks to establish the importance of her case by listing supposed evils of the decision below (Petition, 14-18). These are illusory and may be disposed of summarily as follows:

1. Petitioner has not been "inequitably deprived" of anything. She is in the position of any California bondholder under a mortgage containing restrictions on fore-

closure—the very position she necessarily expected to be in when her bonds were issued and purchased.

2. The *future* effect of the Trust Indenture Act in California and other "one action" states is not in issue. Petitioner has no standing to seek an advisory opinion.

3. No uncertainty in the orderly administration of the Trust Indenture Act results from the decision below because the Securities and Exchange Commission is concerned only with the requirements for qualification of an indenture under the Act and not with judicial interpretation of provisions in a qualified indenture.

4. The state court did not even suggest that "the holders of 75.1 per cent of the bonds may alter the rights of remaining bondholders in any manner they see fit and without the consent of the minority bondholders." The state court simply held that the 1945 Indenture as qualified did not grant petitioner a cause of action which she did not have under the Original Mortgage.

5. The inclusion in California bond mortgages of language required by Section 316(b) of the Trust Indenture Act is not a "trap for the unwary" because that language neither grants nor promises any rights not available under applicable state law.

Petitioner asserts the existence of a substantial federal question in that the Trust Indenture Act of 1939 applies to her bonds and grants her a right to foreclose or to sue at law. We will show that there is no substantial federal question because (a) the Trust Indenture Act of 1939 does not apply to petitioner's bonds issued in 1925; (b) even if the Trust Indenture Act of 1939 did apply to petitioner's bonds, she would have no cause of action.

**A. The Trust Indenture Act of 1939 Does Not Apply to Petitioner's Bonds Issued in 1925.**

The Trust Indenture Act of 1939 provides that it shall not apply to previously sold securities. Section 304(a)(3) reads:

> "The provisions of this title shall not apply to any of the following securities: * * *
>
> "(3) any security which, prior to or within six months after the enactment of this title, has been sold or disposed of by the issuer or bona fide offered to the public, but this exemption shall not apply to any new offering of any such security by an issuer subsequent to such six months; * * *" (53 Stat. 1153, 15 U.S.C.A. § 77ddd(a)(3).)

Petitioner has acknowledged that her "bonds were not issued under the 1945 Indenture, but under the 1925 Mortgage" (R. 70). However, in an effort to avoid the exemption quoted above, petitioner now asserts that because there was a "new offering" of bonds to those who consented to the Plan, somehow that fact makes the Act applicable to her non-consenting bonds. The California District Court of Appeal rejected this contention and held that petitioner's bonds were not a "new offering" and were, therefore, within the express exemption quoted above. *Securities and Exchange Commission v. Associated Gas & Electric Co.*, 99 F.2d 795 (2d Cir. 1938), cited by petitioner (Petition, page 11), holds only that there has been a "new offering" of an *extended* security even though no new certificate was issued in exchange for the old certificate, and the extended maturity date is shown merely by an overstamp on the old certificate. Petitioner cites no authority and we are aware of none suggesting that non-consenting bonds become part of a "new offering" where the new offering does

not even purport to extend the maturity date of the non-consenting bonds. To apply the Trust Indenture Act to bonds which are not themselves a "new offering" would not only ignore the express exemption, but would violate the established rule against giving any statute retrospective effect unless the legislative intention to do so is clearly expressed.[1]

The California court applied the exemption to petitioner's bonds, but it recognized that the 1945 Indenture extended to those bonds all of the rights, provisions, benefits and remedies provided for in favor of consenting bondholders, including the sinking fund, redemption, and waiver of statute of limitations provisions (R. 85, 87). This voluntary extension of the benefits of the 1945 Indenture to the non-consenting bondholders satisfied the requirements for qualification under the Trust Indenture Act as stated by the Securities and Exchange Commission in *Hugo Stinnes Corp.*, 7 S.E.C. Dec. and Rep. 622 (1940). That case requires that non-consenters receive parity of treatment with consenters so far as benefits extended by the new Indenture are concerned. This, petitioner has obtained. Her position is that under the Trust Indenture Act and the 1945 Indenture she acquired rights greater than and different from those accorded to consenting bondholders, viz., the present right to foreclose without the requisite consent or to sue on her bonds without foreclosing. Nothing in the *Stinnes* decision supports that position.

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(1) *Brewster v. Gage*, 280 U.S. 327, 50 S.Ct. 115 (1930); *Claridge Apartments Co. v. Commissioner of Internal Revenue*, 323 U.S. 141, 65 S.Ct. 172 (1944); *Hassett v. Welch*, 303 U.S. 303, 58 S.Ct. 559 (1938); *Miller v. United States*, 294 U.S. 435, 55 S.Ct. 440 (1935); cf. *Addison v. Holly Hill Fruit Products, Inc.*, 322 U.S. 607, 618, 64 S.Ct. 1215, 1221 (1944).

Since petitioner has no rights other than those voluntarily extended to her on a parity with consenting bondholders, the question whether she may foreclose or sue on her bonds by virtue of the provisions contained in the 1945 Indenture is premature. There has been no default under that Indenture and the consenting bondholders have no such right.

**B. Even if the Trust Indenture Act of 1939 Applied to Petitioner's Bonds, She Would Have No Cause of Action.**

The only right petitioner or any other bondholder has under the Trust Indenture Act, assuming that the Act applies to her bonds, is to have an indenture qualified as provided in the Act. Once an indenture has been qualified as the 1945 Indenture was, the requirements of the Trust Indenture Act have been satisfied and the only remaining question is the effect of the provisions of the Indenture including, of course, the provisions required by the Act. The *Stinnes* decision, which was concerned solely with qualification of an indenture, has nothing to do with this case where the 1945 Indenture was admittedly qualified. Consequently, the only question here is whether the last paragraph of Section 10.19 of the 1945 Indenture, which carried into the Indenture the required provisions of Section 316(b) of the Trust Indenture Act, gives petitioner a right to foreclose or to sue on her bond without foreclosing.

The Palace Hotel bond mortgages (i.e., both the Original Mortgage under which petitioner's bonds were issued and sold and the 1945 Indenture which was qualified under the Trust Indenture Act) prohibit foreclosure unless the holders of not less than 25 per cent of the outstanding

bonds agree thereto (R. 61, 35-36). The validity of this provision and its effectiveness as a bar to foreclosure by less than the required percentage is beyond question.[1] The provisions required by Section 316(b) and contained in the last paragraph of Section 10.19 of the 1945 Indenture do not refer to foreclosure at all, but are directed solely to restrictions on suits for payment of the secured obligation. The Securities and Exchange Commission properly permitted the 1945 Indenture to be qualified under the Act although the first paragraph of Section 10.19 contains restrictive provisions on foreclosure (R. 35-36).

California, like other Western states, has a "one action" rule with respect to secured indebtedness.[2] California Code of Civil Procedure, Section 726, provides:

> "There can be but one form of action for the recovery of any debt, or the enforcement of any right secured by mortgage upon real or personal property, which action must be in accordance with the provisions of this chapter [i.e., foreclosure]. * * *"

The purpose and effect of this statute as a matter of California law is correctly stated by the District Court of Appeal in its opinion as follows:

> "The purpose of section 726 is to prevent a multiplicity of actions and to require a secured creditor to exhaust his security before obtaining a personal judgment against the debtor. (Toby v. Oregon Pac. R. R. Co., 98 Cal. 490, 494.) The security is made the primary fund for the discharge of the indebtedness (Bank of Italy etc. Assn. v. Bentley, 217 Cal. 644, 653); the

(1) *Dietzel v. Anger*, 8 Cal.2d 373, 65 Pac.2d 803 (1937); *Lauinger v. Carrillo Building Co.*, 41 C.A.2d 660, 107 Pac.2d 287 (1940); *Rodman v. Richfield Oil Co. of California*, 66 F.2d 244 (9th Cir. 1933).

(2) See footnote, Petition, p. 15.

cause of action on the bonds does not accrue until the security has been exhausted (Commercial Centre R. Co. v. Superior Ct., 7 Cal. 2d 121, 128), and appellant cannot waive her right to exhaust the security by suing on the debt prior to foreclosure, without the consent of the mortgagor. (Barbieri v. Ramelli, 84 Cal. 154; Gnarini v. Swiss American Bank, 162 Cal. 181.)" (R. 92, 93)

Petitioner contends that the provisions of Section 316(b) of the Trust Indenture Act as carried into Section 10.19 of the 1945 Indenture changed this rule and permit her to recover a judgment on her bonds without foreclosing. Assuming, as we do for the purposes of argument, that Section 316(b) as carried into Section 10.19 of the 1945 Indenture applies to petitioner's bonds, it does not purport to grant or create any right where none existed, but it simply provides that the right of a bondholder to receive payment or to institute suit for the enforcement of payment shall not be *impaired* by an indenture, subject to an exception. The exception permitted by the Act and contained in the 1945 Indenture as qualified is "that no Bondholder may institute any such suit, action or proceeding if and to the extent that the institution or prosecution thereof or the entry of a judgment or a decree therein would, under applicable law, result in the surrender, impairment, waiver or loss of the lien of this Indenture upon any property subject to such lien" (R. 36, 84). This exception was specifically designed to accommodate the requirements of Section 316(b) to the "one action" rule.[1]

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(1) The permitted exception was presented by Representative Hinshaw of California as an amendment to Section 316(b) (84 Cong. Rec. 9528, Part 9, 76th Cong., 1st Sess., July 19, 1939), and

The California court in this case has held as a matter of state law that Section 10.19 of the 1945 Indenture, embodying the required language of Section 316(b), does not amount to a waiver of California Code of Civil Procedure, Section 726 (R. 93, 94). This decision presents no federal question. Nor is it in conflict with the *Stinnes* decision, because the Commission was there concerned with the administrative problem of whether an indenture could be qualified under the Act without extending parity of treatment to non-consenting security holders, and not with any judicial question as to the requirements and effect of Section 316(b).

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in explaining the amendment Mr. Hinshaw said: "No doubt if this amendment had been prepared in time, it would have been part of the regular bill. As you have heard, it carries the endorsement of the entire committee. The necessity for it arises from a peculiar circumstance in the laws of my State of California and perhaps several others of the Western States. The law of California differs from the law prevailing generally in providing that there can be but one action to foreclose a mortgage. Since 1898 it has been the settled law of California, *Commercial Bank v. Kershner* (120 Cal. 495), and numerous other cases following it, that if the holder of a mortgage note recovers a judgment on such note, without foreclosing the mortgage, he thereby waives entirely the mortgage security. For this reason California attorneys have been careful in drafting indentures secured by property in California to provide that individual bondholders have no right of action upon the bonds, as distinguished from such right as they may be given—generally based on the refusal of the trustee to act, after appropriate request—to foreclose the indenture. Where the trustee is given the power to sue upon the bonds, as distinguished from the power to foreclose the indenture, the added provision is inserted that such power of the trustee is subject to the limitation that if the exercise of such power would result in the security being surrendered, waived, or lost, the trustee shall not have such power prior to foreclosure of the indenture. Mr. Chairman, I ask the favorable consideration of the Committee for my amendment." (Ibid., 1 CCH Fed. Sec. L. Serv., para. 14,221.12). Thus it is clear that the exception preserved the "one action" rule against peradventure of argument that Section 316(b) was intended to destroy it.

It is significant that the restriction against an action by petitioner on her bonds arises not from the provisions of the indenture, as it did in *Allan v. Moline Plow Co.*, 14 F.2d 912 (8th Cir. 1926)[1] but from the effect of California Code of Civil Procedure, Section 726 as consistently construed by the California courts.

## CONCLUSION

In seeking certiorari petitioner asserts, in combination, that (1) the Trust Indenture Act of 1939 is deemed to apply to petitioner's bonds which were issued and sold in 1925, notwithstanding the express exemption contained in Section 304(a); (2) the consenting bondholders by adopting the Plan gave petitioner a right to foreclose which she did not have before, although this would frustrate the entire purpose of the Plan; (3) Section 316(b) of the Trust Indenture Act creates a cause of action for foreclosure or on the bonds where none existed before, although the express language of the section merely protects existing rights against impairment, and does not purport to grant or create any right whatsoever; (4) Section 316(b) of the Trust Indenture Act overrides the "one action" rule embodied in California Code of Civil Procedure, Section 726, although the stated purpose of the Hinshaw amendment was to preserve that rule.

The California courts have held in this case that petitioner has no cause of action to foreclose the Mortgage, because of the valid restrictions therein, and that she cannot sue on the bonds because of the "one action" rule embodied in California Code of Civil Procedure, Section 726. This is

(1) See Petition, p. 17.

in accord with well established rules of local law and leaves petitioner in the position of any other California bondholder under a mortgage which contains restrictions on foreclosure.

The Trust Indenture Act of 1939 left petitioner where it found her. It has no retroactive application to her previously issued bonds and it creates no cause of action where there was none. No substantial federal question is presented. Certiorari should be denied.

Respectfully submitted,

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